United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING

76-5007

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

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76 - 5007

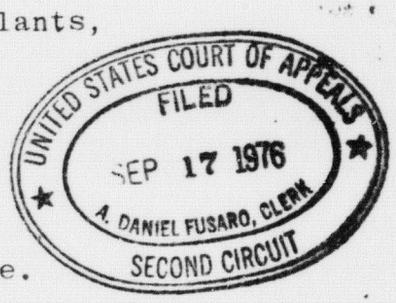
CAMELIA BUILDERS, INC., E.J. YELVERTON, JR. FARNALE, INC., R.L. GOODALE and JEFFREY H. HUBBARD,

Respondents-Appellants,

versus

FIDELITY MORTGAGE INVESTORS, Debtor,

Applicant-Appellee.



APPELLANT'S PETITION FOR REHEARING

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK
HONORABLE RICHARD OWEN, JUDGE PRESIDING

Jeffrey H. Hubbard
2297 Two Shell Plaza
Houston, Texas 77002
(713) 225-0837

ATTORNEY FOR APPELLANTS

INTRODUCTION

Now comes Camelia Builders, Inc., E.J. Yelverton, Jr., Farnale, Inc., R.L. Goodale and Jeffrey H. Hubbard, Appellants (Respondents) and respectfully petition for rehearing by the Court in banc of the Court's decision of September 3, 1976 which affirmed the District Court's adjudication that Respondents are guilty of civil contempt by reason of having instituted suit in the United States District Court for the Southern District of Mississippi (Mississippi Action) against Fidelity Mortgage Investors (FMI), a debtor in possession under Chapter XI of the Bankruptcy Laws on the procedural ground that Respondents should have secured permission from the Bankruptcy Court prior to commencement of the Mississippi Action. Respondents reserve their argued positions as to each of the points of appeal but address themselves herein solely to those features of the decision wherein they believe the Court may be convinced the result is based upon a misconception of the facts and application of incorrect legal principles.

This petition for rehearing is based upon the following points:

1. The Court has misunderstood the facts concerning whether FMI has a "first" deed of trust to secure its loan, that the existence of the Chapter XI proceeding was a cause of great concern to Respondents, that Respondents instituted the Mississippi Action to insure superiority of their lien, that Hubbard confirmed the existence of the Chapter XI proceeding the day before the institution of the Mississippi proceeding, that FMI was required to tender approximately $76,000 of its money into the registry

of the Mississippi Court, and that Respondents had time to approach the Bankruptcy Court in New York as a result of the institution of the foreclosure proceedings by FMI.

2. The Court has erred in substantially expanding the jurisdiction of a Bankruptcy Court in a Chapter XI arrangement and its construction of the rules pertaining to same which is a matter of exceptional importance to our jurisprudence.

3. The Court has erred in impliedly overruling, without ever mentioning same, prior decisions of this Court of nationwide importance pertaining to notice of injunctions and jurisdiction of the Bankruptcy Court pertaining both to the debtor and its property and contempt in bankruptcy proceedings.

4. The Court has erred in failing to apply the law of the State of Texas to Respondent and in holding counsel in contempt.

5. The Court has erred in attempting to resolve property law issues in a contempt proceeding.

6. The Court erred in failing to dismiss this proceeding for conflict of interest.

ARGUMENT

1.FMI has filed a petition pursuant to Chapter XI of the Bankruptcy Laws, 11 U.S.C. 701 and by reason of the provisions of 11 U.S.C. 702, the provisions of the Bankruptcy Act pertaining to Chapter X corporate reorganizations are not applicable thereto. 11 U.S.C. 511. FMI did not receive, as admitted by its counsel, a "first" deed of trust lien on the property (39).

No money belonging to FMI was tendered in the Mississippi Action. (139) The only reason for the contractors initiating the Mississippi Action was the revelation to Respondents on or about March 20, 1975, by Mr. Tom Crockett, Mississippi counsel for Respondent and, unknown to Respondents, also counsel for FMI, that FMI had commenced a foreclousre proceeding and that same could cut off the contractor's, mechanics and materialman's lien which sale was to be conducted on March 28, 1975. (77,110 and 129) The Mississippi Action was instituted on March 24, 1975 (108) and on same date but later in the day Respondent Hubbard confirmed that FMI had filed a Chapter XI but that no order of any kind had been entered. (78 and 79a) (please note that page 79 of the appendix is out of order and should follow page 79a,) Respondents were precluded in time after learning of the Chapter XI in the afternoon of March 24, 1976 from being able to approach the Bankruptcy Court prior to the scheduled foreclosure sale ordered by FMI. (77) Additionally, the same argument has been advanced in all briefs filed by Appellants without contradiction by FMI herein.

2. The impact of the Court's decision herein is to extend the jurisdiction of a Bankruptcy Court sitting in a Chapter IX arrangement, which by definition is to affect only unsecured creditors of the debtor (11 U.S.C. 707) to secured creditors of the entity which is an alleged debtor of the party having invoked the Chapter XI arrangement; and that where such secured party is a mechanic's and materialman's lien claimant located in Jackson, Mississippi. This Court's reliance for its determination of the jurisdiction

of the Bankruptcy Court upon Fritz v. United States, 535 F. 2d., 1192 (9th Cir. 1976) to the effect that the Customs Court shall have exclusive jurisdiction of all civil actions in connection with the Tariff Act of 1930 and 6 Collier, Bankruptcy 3.03 at 424 (14th ed. 1972) defining the jurisdiction of the Bankruptcy Court in a Chapter 10 corporate reorganization (11 U.S.C. 511) shed no light on the issue. If a parallel is to be drawn between Chapter 10 proceedings and Chapter 11 proceedings it appears of interest to note that 11 U.S.C. 516 provides that in a Chapter 10 the Court may stay any act or proceedings that enforce a lien upon the property of the debtor, whereas in a Chapter XI proceeding 11 U.S.C. 714 provides the Court may stay the commencement or continuation of suits other than suits to enforce liens upon the property of the debtor and may only stay suits to enforce liens upon notice and for good cause shown. Of course, the Chapter XI Court has never had jurisdiction of property not belonging to the debtor (see Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F. 2d., 114 (10th Cir. 1974) and In Re: Texas Consumer Finance Corporation 480 F. 2d., 1261 (5th Cir. 1973).

There is nothing novel about the property rights of a beneficiary of a deed of trust to those accustomed to the system, but admittedly same may seem so to a Court situated 2,000 miles away. It appears clear that property rights are to be determined according to the laws of the state and FMI has no property rights at any time material hereto in the condominium project pursuant to its deed of trust. (Baker v. Connecticutt General Life Ins. Co., 18 So. 2d., 438 (Miss. 1944)

The purported expansion of Rule 11-44 to the instant lien holders constitutes an expanse of jurisdiction (11 U.S.C. 714) and the jurisdiction must be strictly confined within the prescribed limits of the act. (In Re: Texas Consumer Finance Corp., supra.) This Court's holding that a "rule" is the same as an "order" for purposes of contempt implies surplusage on the part of the Supreme Court of the United States in drafting Rule 770 of the Bankruptcy Rules.

3. The decision of this Court effectively overrules Berry v. Midtown Service Corporation, 104 F. 2d 107 (2nd Cir. 1939)cert. granted, 308 U.S. 536, appeal dismissed per stipulation, 308 U.S. 629 (1939) requiring a strict construction of contempt of jurisdiction, In Re: Grissler 136 F. 754 (2nd Cir. 1905) pertaining to the jurisdiction of the State Court by reason of the prior existing lawsuit, O'Hagan v. Blythe, 354 F. 2nd 83 (2nd Cir. 1955) In Re: Schwartz, 14 F. 787 (D.C.N.Y. 1882) requiring that the District Court conduct its own fact finding hearing in a certification for contempt which was not done in the instant case and appears to have considerable impact upon In Re: Willax, 93 F. 2d 292 (2nd Cir. 1937)to the effect that a contractor is obligated to preserve and protect his lien notwithstanding a stay order otherwise it is lost.

4. The Court has erred in failing to note that while Respondents are sued in their individual rights for their acts in furtherence of the contractor's interests, under Texas law in such capacity they are liable only for intentionally inflicted bodily injury and that an error in judgment, if any there be, exonerates

them from any other liability. Freeman v. Ferguson, 292 SW 2d 632 (Texas 1956). As to counsel for the joint venture the Court overlooks the recent holding in Imbler v. Pachtman, 96 S.Ct. 984 (1976) and Vern. Anno. Civ. Stat., Tit. 14, Art. 12, Sec. 8, Can. 7 which provides in part as follows:

> "The duty of a lawyer, both to his client and to the legal system. . .is to represent his client zealously within the bounds of the law..."
>
> "While serving as advocate, a lawyer should resolve in favor of his client doubts as to the bounds of the law. . ."
>
> "His conduct is within the bounds of the law, and therefore permissible, if the position taken is supported by the law or is supportable by a good faith argument for an extension, modification, or reversal of the law. . ."
>
> "The duty of the lawyer to his client and his duty to the legal system are the same: to represent his client zealously within the bounds of the law."

5. In attempting to resolve within the contempt proceedings all of the property issues involved, the Court overlooks the clear instructions contained in Maggio v. Zeitz, 333 U.S. 56, 92 L.Ed. 476 (1947) to the effect that before contempt will lie, all property issues must first be resolved.

6. Inadvertently, proposed page 32-A of the Appendix is apparently missing from most copies thereof. Attached hereto are pages 35 and 36 of the Transcript of Proceedings of April 10, 1975 which is Item 21 to the Index to the Record on Appeal. Beginning on page 36, lines 13 through 17, it is crystal clear that Mr. Thomas Crockett, Mississippi counsel for Respondents herein (113, 124) was associated with Mr. Jim Young and FMI in conducting the foreclosure sale and same may well explain

why Respondents were unable to verify the existence of the Chapter XI in a timely manner or to learn in a timely manner of the proposed foreclosure. Authority cited page 44 of Appellants' Brief.

CONCLUSION

In the event this Court now elects to hold that Rule 602 is not applicable to Chapter XI notwithstanding the provisions of Rule 11-49, then it appears that FMI was without authority of the Bankruptcy Court to conduct the foreclosure sale as Judge Herzog has based its only authority on Bankruptcy Rule 610 with the result that Respondents are held in contempt of Court for attempting to preserve and protect the mechanic's and materialman's lien of the contract notwithstanding that FMI was then violating the state law of Mississippi in the manner in which it conducted the foreclosure and the Bankruptcy law as it had no authority to conduct same. For the foregoing reasons, Respondents request an opportunity to rehearing on these points. Because of the fundamental nature and importance of the issues, it is requested that the rehearing be before the entire court sitting in banc.

Respectfully submitted,

JEFFREY H. HUBBARD
Attorney for Appellants
2297 Two Shell Plaza
Houston, Texas 77002
(713) 225-0837

CERTIFICATE OF SERVICE

I hereby certify that two copies of the foregoing Appellants' Petition for Rehearing was served by messenger on Weil, Gotshal & Manges, counsel for Appellee, 767 Fifth Avenue, New York, New York 10022 on this 17th day of September, 1976.

JEFFREY H. HUBBARD

MR. KRASNOW: If your Honor will recall, you have sustained our objections to the whole line of questioning with respect to this.

THE COURT: Yes. Anyhow, counsel wants me to take judicial notice of the existence of the law and I will do that.

MR. HUBBARD: Thank you, your Honor.

J A M E S L E O N A R D Y O U N G, recalled as a witness, having been previously duly sworn, resumed the stand and testified further as follows:

CROSS EXAMINATION

CONTINUED BY MR. HUBBARD:

Q Will you tell the Judge, please, Mr. Young, whether or not on March 18, 1975 there was posted on the courthouse door of the Rankin County Courthouse in Rankin County, Miss., a notice of the Deed of Trust foreclosure on the property that is the basis of this proceeding?

A May I inquire procedurally: are you still on the proffer or have you completed your proffer?

THE COURT: He is asking a question.

MR. KRASNOW: Excuse me, your Honor, is this part of the proffer?

MR. HUBBARD: Yes, sir.

MR. KRASNOW: Your Honor, I think to expedite matters now before me, that I have before me, and that

THE COURT: Let him answer. Let's get it into the record.

A Did you say was it posted on the courthouse door?

Q Yes.

A Never. But I have before me is this: that a petition

Q C Was it posted on the bulletin board of the courthouse?

A Well, if I am to be technical with Mr. Hubbard, I don't know whether it was or not but on or about that date Mr. Crockett, who was then associated with me in the matter called me and informed me that he was at the Rankin County Courthouse and could not find the notice on the board, and I advised him that I would have a copy of it at his office within an hour, which I did.

I then had a duplicate of it taken to the courthouse and put back on the bulletin board, on or about March 20, 1975 by Mr. Shows.

THE COURT: It seems to me what you are trying to do is to show that the foreclosure sale was conducted under the Deed of Trust pursuant to 89-1-155, and that the sale was invalid because it did not comply with the section.